August 25, 2008

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

Dear Ms. Rupp:

Re: Comments on Advanced Notice of Proposed Rulemaking for Part 723

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on NCUA's advance notice of proposed rulemaking (ANPR) in which the agency has requested comments on how the member business lending (MBL) rules—contained in NCUA's Regulations Part 723—should be revised or clarified. By way of background, the California and Nevada Credit Union Leagues are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 9 million members.

The Leagues appreciate NCUA's willingness to consider amending its MBL rules, as the outdated, restrictive, and inflexible nature of the regulation has continued to hamstring credit unions' efforts to structure business loan packages that meet their members' needs and expectations. While we understand that some of these limitations are caused by the statutory constraints imposed by the Federal Credit Union Act, a substantial number of them can be found in Part 723. Our comments are provided in an attempt to address the restrictiveness of the regulation, while recognizing the continued need to maintain the safety and soundness of insured credit unions, as well as to provide credit union members with access to reliable sources of credit.

Loan-To-Value (LTV) Ratio Requirements

Generally, the MBL rule requires all MBLs to be secured by collateral. The maximum LTV ratio permitted for all liens is 80% unless the amount in excess of 80% is covered by private mortgage insurance or is otherwise insured, guaranteed, or subject to an advance commitment to purchase by certain government agencies. In any event, the LTV ratio may not exceed 95%. For construction and development loans (C&D loans), the borrower must have a minimum of 25% equity interest in the project being financed (the value of which is determined by the market value of the

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project at the time the loan is made[1]), which translates to a maximum LTV limit of 75%.

Construction and Development Loans
The Leagues agree with and support credit union comments already submitted to NCUA regarding the advisability of (a) eliminating the equity method of calculating the maximum loan amount for C&D loans and instead replacing it with the more traditional use of loan-to-value ratios to calculate the maximum loan amount; (b) establishing the maximum LTV ratio for C&D loans at 80%; and (c) permitting the use of the "as completed" value of a C&D project for purposes of calculating the LTV ratio. We find such an approach to be thoughtful, reasonable, and balanced, as well as more representative of current—and prudent—construction loan underwriting practices.

Further, we agree with comments which note that the use of the equity method has been a source of frustration to experienced C&D credit union lenders for a number of reasons. First, NCUA's use of its own definition of "market value" in calculating the equity requirement appears to be in conflict with the provisions of the Appraisal Regulation set forth in Part 722. Second, we note that in many cases the equity requirements can have the effect of increasing the lender's risk, rather than decreasing such risk. Finally, the use of an equity requirement in place of an LTV requirement has not been widely accepted in the construction lending industry.

The Leagues would like to point out that financial institutions regulated by the federal banking agencies (FDIC, FRB, OTS, OCC) are permitted to make construction loans up to 80% LTV (and higher under certain circumstances). While using 80% as a maximum cap (instead of a 75% maximum cap) may slightly increase a credit union's risk exposure, we believe that any such increase in risk is not material and, notwithstanding, will be counterbalanced by the adoption of the "as completed" valuation method. Further, any heightened risks identified in the underwriting process can typically be mitigated by imposing additional loan conditions.

Use of LTV Tiers
NCUA has indicated it would like comments on whether the differences between various kinds of collateral would support using a tiered approach to LTV limits so that a loan secured by safer collateral would have a higher LTV limit. The Leagues are of the opinion that such an approach would enable NCUA to more accurately reflect the

[1] NCUA's formula for calculating "market value" is set forth in the preamble to the final regulation at 68 FR 56540 (October 1, 2003). Market value is defined as "the appraised value of land owned by the borrower on which the project is to be built, less any liens, plus the cost to build the project." Essentially, the NCUA appears to require the use of a modified cost approach to determine value.

risk differences in various types of MBLs, while increasing credit union flexibility and competitiveness, and without jeopardizing credit union safety and soundness. We support the following maximum LTV limits for various loan/collateral types as already recommended to the NCUA:

Loan/Collateral Type	Maximum LTV
Loan to finance non-owner-occupied C&D Project (secured by C&D Project)	80%
Loan to finance owner-occupied C&D Project (secured by C&D Project)	85%
Loan to finance C&D, but secured by collateral other than the C&D Project itself	90%
All other loan types/collateral types	90%
Car, van, truck, sports-utility vehicles (non-fleet)	100%

Alternatively, we suggest that the NCUA may want to consider adopting the regulatory framework used by the other federal banking agencies (FDIC, OTC, OCC) as set forth in the FFIEC Interagency Guidelines for Real Estate Lending Policies (Title 12, part 365, subpart D, Appendix A).

Exclusions from the Definition of Member Business Loan and C&D Loan
Member Business Loan
The Leagues respectfully urge the NCUA to consider changing the definition of a MBL to exclude non-owner occupied one-four family residential real estate loans. In our view, the expertise required to originate, service, and manage credit risk for typical commercial loans is distinct and not analogous to that involving one-four family residential real estate loans. The complexity of a typical borrower for each loan is different, the expertise required to underwrite the loans is not comparable, and the required management experience necessary to mitigate risk is not the same for both types of loans. If NCUA elects not to completely eliminate one-four family residential investment property loans from the definition of MBL, we suggest that the agency qualify an exclusion from MBL coverage if the underwriting of the loans conforms to standard Freddie Mac or Fannie Mae guidelines. This would help to maintain credit standards, address any loan-to-value concerns, and also provide an opportunity for liquidity to the portfolio.

C&D Loan
The Leagues join other credit union commenters in requesting that NCUA exclude owner-occupied construction loans from the aggregate C&D lending limit provided in §723.3(a). Many experienced credit union business lenders, and other regulators, have found that owner-occupied construction loans expose lenders to less risk (e.g., impact

of construction risk, real estate market risk, repayment risk) than "speculative" construction loans with which NCUA has historically been concerned. For example, this distinction has been observed by the Comptroller of the Currency in their handbook entitled "Commercial Real Estate and Construction Lending," which states (page i, Introduction and Background):

> "Loans secured by real estate can be divided into two categories based on the source of repayment: credit-based loans and project financing. Credit-based loans are loans secured by real estate that will be repaid from the borrower's business operations or personal assets. Although the primary collateral for the loan is real estate, the real estate is not the source of repayment. In many instances, these loans are used to finance the acquisition of an owner-occupied business premise that has an economic life similar to the term of the loan. In other cases, they are term loans used for other business purposes, such as working capital. In both cases, however, repayment is expected from the cash flow of the business rather than the underlying real estate. Examiners should evaluate credit-based real estate loans in essentially the same manner as commercial loans."

The Leagues believe that such a modification will help provide increased flexibility to credit unions without providing additional risk.

Waivers
The MBL rules provide waivers from a number of requirements in the MBL rule. NCUA is concerned that credit unions may not be taking full advantage of these waiver opportunities, and has requested comment as to whether this is the case. The Leagues believe that this is true, and propose that credit unions that 1) meet RegFlex standards; 2) meet the experience requirements found in §723.5; and 3) have been engaged in prudent MBL lending for at least five years be granted an automatic waiver from the LTV ratio requirements of the regulation. This would give experienced, stable credit unions greater flexibility to determine the appropriate level of collateralization based on the relative strength of the borrower and the overall structuring of the loan request, allowing them to remain competitive in their respective business lending markets.

At the very least, we recommend that the process of applying for a waiver be streamlined for those credit unions that meet RegFlex standards. Under current guidelines found in §723.10, a waiver request must include an abundance of documentation, including:

- A copy of the credit union's business lending policy;
- An explanation of the need to raise the limit (if applicable);
- Documentation supporting the credit union's ability to manage the activity; and
- An analysis of the credit union's prior experience making member business loans that must, at a minimum, address seven specified factors.

In addition, once submitted, the NCUA Regional Director has up to 45 days to respond to a waiver request. We feel that a rapid application and approval process for RegFlex credit unions would encourage more use of waivers and improve credit unions' ability to serve their members, without raising safety and soundness issues. Further, NCUA may want to consider providing the option of applying via this streamlined process through a credit union's regular examination process. This would eliminate the need to provide the detailed package of information to a Regional Director, who usually has much less contact and familiarity with the particular credit union. Or, credit unions could be given the option to apply for the waiver through a streamlined online application, similar to the current Field of Membership Internet Application (FOMIA).

Prepayment Penalties

While the Leagues support the prohibition of prepayment penalties on consumer loans, we feel that credit unions should be permitted to charge them on MBLs. These penalties are common contractual stipulations in the commercial lending industry, designed to compensate for the substantial underwriting and servicing investment needed to make a commercial loan. Although many credit unions may elect to not include them in their contracts—or to not enforce them in all cases, if included—we believe that permitting credit unions to include them can be an effective competitive and risk management tool.

In closing, I would like to thank NCUA for the opportunity to comment on these proposed changes to the MBL rules. We appreciate your careful consideration of our views, and commend the agency on its efforts in crafting more effective, relevant regulation to permit credit unions to serve members' evolving financial needs.

Sincerely,

Bill Cheney
President/CEO
California and Nevada Credit Union Leagues